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Central Intelligence Agency



Washington, D.C. 20505

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DIRECTORATE OF INTELLIGENCE

12 April 1990

Iraq: No End in Sight to Debt Burden [REDACTED]

Summary

Iraq faces serious problems servicing its foreign debt. Baghdad is unlikely to begin paring down its \$45 billion debt any time soon because it considers most debt repayment a low priority in favor of spending on strategic military and civilian projects, and it is incurring new debt.

- o *Despite a dismal repayment record, Iraq will probably continue to secure debt relief--including limited new credits--from most of its creditors, who have little other choice if they hope to receive any repayment or compete in the potentially lucrative postwar Iraqi market.* [REDACTED]

Debt remains the major constraint to Iraq's postwar economic recovery.

- o *Debt payments will siphon off financial resources well into the 1990s.*
- o *Although Baghdad will try to insulate military and oil projects from financial constraints, its poor repayment record will restrict its access to new financing of the magnitude needed to fund many reconstruction projects and to increase imports enough to spur growth in nonoil sectors.* [REDACTED]

Baghdad probably wants to maintain access to credit guarantees available from the United States despite recent political strains in the relationship. Any loss of these guarantees would jeopardize adequate servicing of about \$2 billion in Iraqi debt backed by the United States. Baghdad would probably not suspend payments if Washington refused to release the remaining \$500 million of \$1 billion in CCC credit guarantees allocated to Iraq for FY1990 but almost certainly would if the entire CCC program were cancelled or seen to be politically dead because of Congressional opposition. [REDACTED]

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This memorandum was prepared by [REDACTED] Office of Near Eastern and South Asian Analysis. Questions and comments are welcome [REDACTED]

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From Richer to Poorer

Iraq's extensive use of foreign loans since 1982 has transformed it from one of the Third World's richest countries and net creditors into one of its problem debtors. The accumulation of debt stems from President Saddam Husayn's decision to continue pursuing an ambitious economic development program despite the outbreak of war with Iran in 1980. Iraq boosted civilian spending while military expenditures rose and oil exports fell sharply because of the war. This "guns and butter" policy rapidly drained Iraq's foreign assets from \$36 billion in 1980 to \$7 billion in 1982. Foreign assets stood at about \$3.5 billion at the end of last year. [REDACTED]

In response to the worsening financial situation, Baghdad adopted domestic austerity measures and began borrowing heavily from abroad in 1983. It obtained more credits and credit guarantees from foreign governments, commercial banks, and private firms to finance imports--including some military equipment--and projects. We estimate Iraq's foreign debt increased [REDACTED]--mostly short-term trade credits--before the war to [REDACTED] by the end of 1989. Its Persian Gulf allies provided [REDACTED] in wartime financial assistance, mostly oil sold on Baghdad's behalf that is unlikely to be repaid. [REDACTED]

Iraq has experienced payment problems since 1983 that have forced it to reschedule the bulk of payments due annually--including short-term credits, interest payments, and previously rescheduled debt--and accumulate large arrears. It has negotiated debt rescheduling agreements on a bilateral basis in an effort to play creditors off against each other and obtain concessional repayment terms. Debt servicing problems climaxed in 1986, when world oil prices plummeted and large debt payments fell due. Iraq's already dismal payment record worsened, causing creditors that had not already cut off credit lines to do so and forcing Baghdad to scramble to pay for essential civilian imports. [REDACTED]

Debt Problems Persist in Postwar Period

Saddam's policy is to treat most debt servicing as a low priority in favor of reconstructing the economy, improving depressed living standards, and maintaining high military spending. Press reports indicate the regime has embarked on a \$37 billion multiyear investment plan for postwar reconstruction and development of industry and infrastructure. Baghdad has spent several billion dollars since the August 1988 cease-fire constructing oil export facilities, expanding port facilities, repairing damaged industries, and rebuilding the cities of Al Basrah and Al Faw, [REDACTED]. It also boosted civilian imports last year by nearly 20 percent to the highest level since 1982 to help meet pent-up consumer demand and quiet popular grumbling. Although imports of military materiel were reduced by \$2 billion last year, we believe the regime diverted most if not all of these savings to the development of its own military industries. The acquisition of new financing for postwar projects and imports has complicated debt servicing woes because most of these credits are short-term, adding further burden to Iraq's heavy repayment schedule in the next two years. [REDACTED]

We estimate Baghdad met only [REDACTED] of [REDACTED] principal and interest payments due in 1989 despite a 30-percent rise in oil revenues for the year. It rescheduled nearly \$2 billion owed to France, West Germany, and Italy and is trying

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to reschedule remaining payments that were due to other creditors in 1989, according to [REDACTED] press reporting. To conserve foreign exchange, Baghdad used oil to repay debt to several major creditors last year, including Japan, Turkey, Brazil, and Yugoslavia. Although we estimate it repaid [REDACTED] more in 1989 than the year before, it did so in most cases to unlock new credits, thus preventing a net reduction in its debt. [REDACTED]

Baghdad continues to repay its debt on a selective basis, giving priority to suppliers of key goods or new credits as well as to important political allies:

- o It generally has made prompt payments for important oil projects, including the construction of its pipeline through Saudi Arabia and the restoration of its offshore oil terminal at Mina al Bakr.
- o The United States has received timely debt payments, mostly because it has provided significant new agricultural credit guarantees since 1983.
- o Iraq has granted priority in recent years to repaying its debt to Jordan--mostly in the form of oil deliveries--because of its gratitude for Jordanian support during the war as well as concern about Amman's serious economic problems.
- o Baghdad began making back payments on Egyptian remittances late last year after publicity about its mistreatment of Egyptian workers risked a serious disruption of its relations with this important Arab Cooperation Council ally.

In contrast, major creditors generally have had to bear the brunt of Baghdad's debt servicing problems. [REDACTED]

Iraq's persistent debt servicing problems have restricted severely its access to new loans. Most commercial banks remain unwilling to extend unsecured loans to Baghdad. Several governments--in an effort to promote exports--have agreed to guarantee more trade and project financing since the cease-fire, giving Iraq access to about \$5 billion in financing last year.¹ Most of these credits are short-term, however, and contingent upon repayment of old debt, allowing Baghdad to merely roll over its debt to some creditors. [REDACTED]

Outlook

We believe debt problems will remain the major constraint to Iraq's postwar economic recovery. Debt payments will siphon financial resources away from more productive uses well into the 1990s. Although we believe the regime will try to insulate high-priority military and oil projects from its financial constraints, its poor debt servicing record will restrict access to new financing of the magnitude needed to fund many reconstruction projects and to increase imports of raw materials and equipment enough to spur growth in nonoil sectors. [REDACTED]

¹ Nearly all of the government credits and credit guarantees available to Iraq are tied to the purchase of goods and services from firms in these countries. [REDACTED]

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Iraq will probably not begin paring down its debt for several years. Repayment of most old debt will remain a relatively low priority in favor of spending on strategic military and civilian projects, particularly in view of the regime's confidence that it can secure concessions from its creditors. In addition, Baghdad will incur new debt as it obtains financing for reconstruction projects and higher levels of imports. We believe it will try to reschedule at least half of the \$7 billion due annually during the next few years. [REDACTED]

Despite its dismal repayment record, we believe Baghdad will continue to secure debt relief in the form of reschedulings and limited new credits from most of its creditors, [REDACTED]

- o Most creditors probably realize that providing such concessions is the most effective way of eliciting at least some repayment of old debt from Iraq.
- o Many creditor governments are heavily dependent on oil imports and want to maintain good relations with Iraq, which possesses the second largest proved oil reserves in the world.
- o Many governments are likely to supply a limited amount of new credits or credit guarantees because they are under pressure from domestic firms anxious to participate in this potentially lucrative market.

We believe competition between government creditors to help their firms gain a foothold in the Iraqi market will continue to discourage them from banding together to force Baghdad to negotiate debt accords on a multilateral basis--as most debtors do--except in the unlikely event that Iraq ceases servicing its debt altogether. [REDACTED]

Implications For the United States

Although ties with Washington have been damaged by several recent events, Baghdad probably wants to maintain access to credit guarantees available from the Commodity Credit Corporation (CCC) and Eximbank. Iraq relies on the CCC program, in particular, to import a significant amount of food and other agricultural commodities on credit. In addition, Baghdad believes the provision of these credit guarantees sends a positive signal to other lenders that Washington has confidence in Iraq's creditworthiness, [REDACTED] The loss of the CCC program would lead Iraq to seek agricultural goods from alternate suppliers willing to sell on credit. Although few individual countries would be likely to supply new credits to Baghdad at a level commensurate to the CCC any time soon, Iraq would probably be able to access smaller credit facilities available from several countries. [REDACTED]

Any loss of US credit guarantees would jeopardize continued adequate servicing of about \$2 billion in Iraqi debt backed by the United States. We believe Baghdad would continue to make repayment to Washington a priority only if it believed doing so would help restore the credits in the short term. If Iraq believed there was no possibility for new credits, the United States would lose its special repayment status, in our judgment. Baghdad would probably not suspend payments if Washington refused to release the remaining \$500 million of \$1 billion in CCC credit guarantees allocated to Iraq for FY1990 but almost certainly would if the entire CCC program were cancelled or seen to be politically dead because of Congressional opposition. [REDACTED]

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US-Iraqi Commercial Relations

The provision of US credit guarantees to Iraq has buoyed the substantial increase in bilateral trade since 1983. The extension of \$4.7 billion in credit guarantees by the CCC in 1983-90 has helped Iraq become the largest Middle Eastern market for US agricultural goods and a major world market as well. Substantial agricultural sales--which comprise about 85 percent of US sales to Iraq--have helped make Washington a major source of Baghdad's civilian imports. Iraq has also utilized \$200 million in short-term credit guarantees available from Eximbank since 1987. [REDACTED]

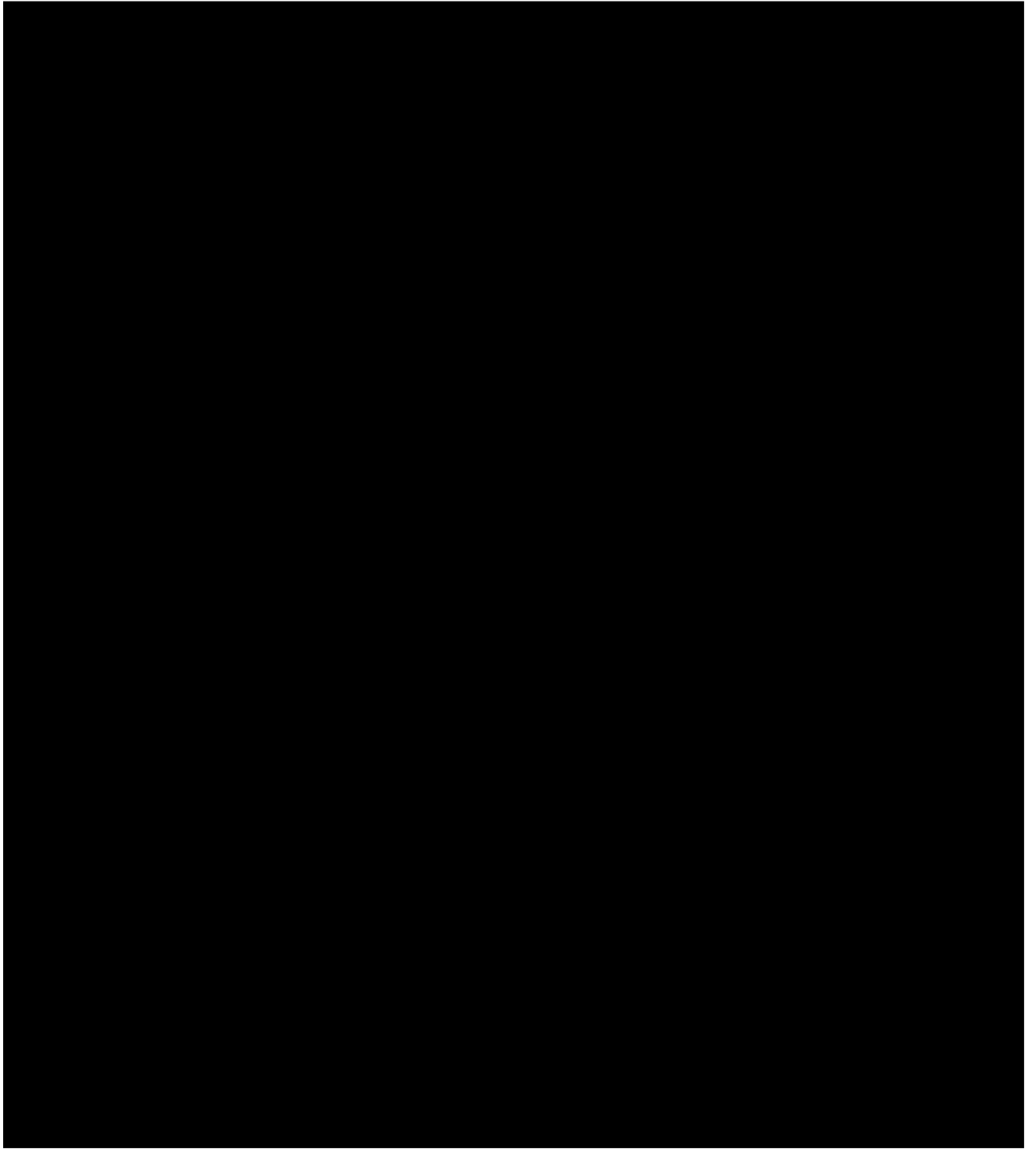
US imports from Iraq have also increased significantly. US purchases of Iraqi oil have jumped from about 80,000 b/d in 1985-87 to 675,000 b/d so far in 1990--about 24 percent of Baghdad's total oil exports and eight percent of net US oil imports. [REDACTED]

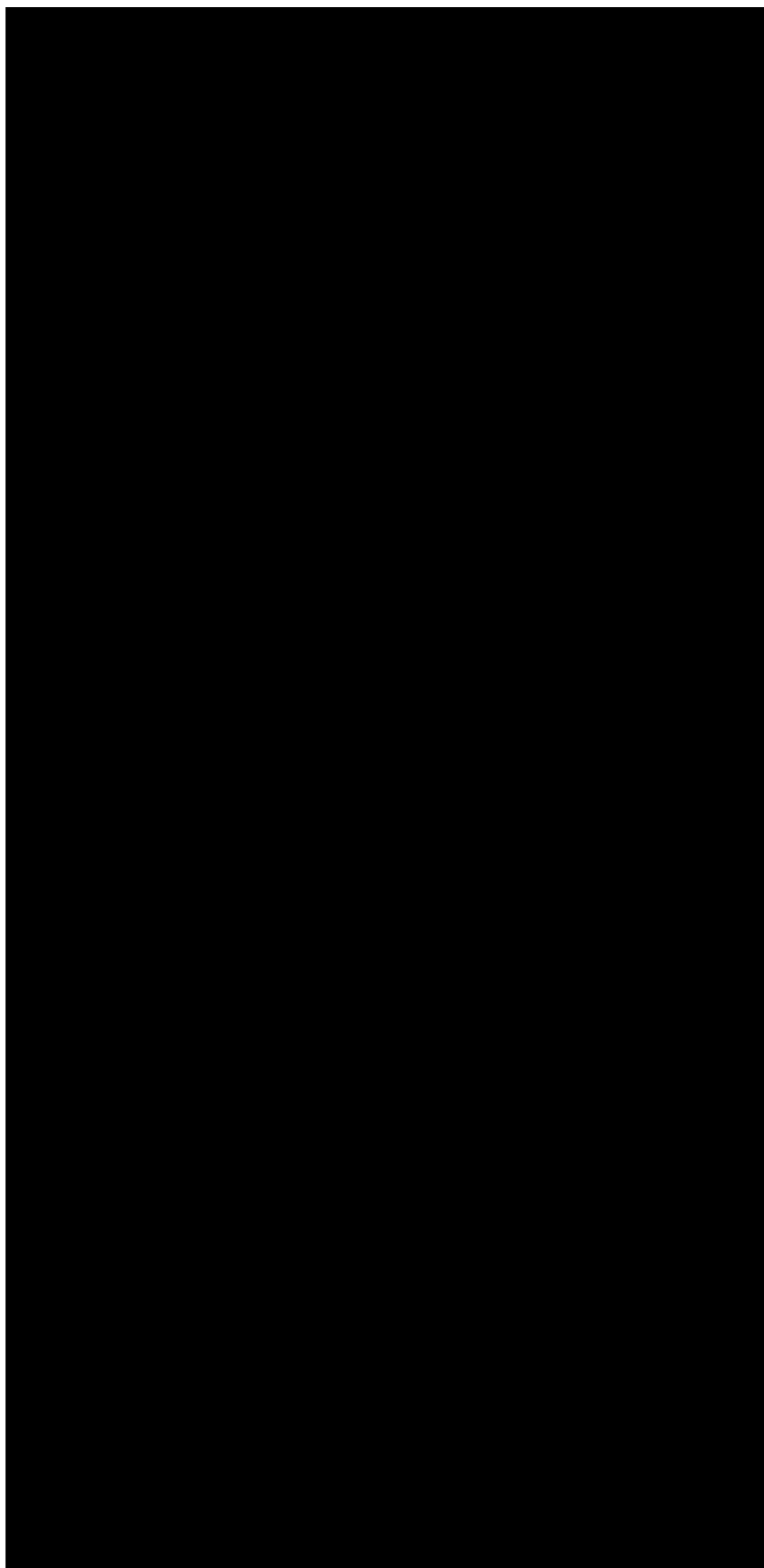
Iraq has pursued closer bilateral commercial ties because it wants to increase its economic importance to the United States in hopes of offsetting what Baghdad regards as Iran's greater geopolitical value to Washington. In addition, the Iraqis have high regard for US goods and technology. To encourage stronger ties, Baghdad has:

- o Treated Washington as a favored creditor; as recently as February Iraqi diplomats told US officials that Iraq continues to give preference to repayment of about \$2 billion in US-guaranteed debt.
- o Lobbied for medium-term credit guarantees from Eximbank and pushed for the formation of a joint economic commission.
- o Stressed the prospects for lucrative contracts in Iraq in the future as well as the importance of its massive oil reserves to long-term US and Western energy needs.

Iraq also gave extensive publicity to the US pavillion at the annual Baghdad Trade Fair last November, including the unprecedented visit of Iraqi Deputy Prime Minister Sadun Hammadi and two other ministers to the pavillion. [REDACTED]

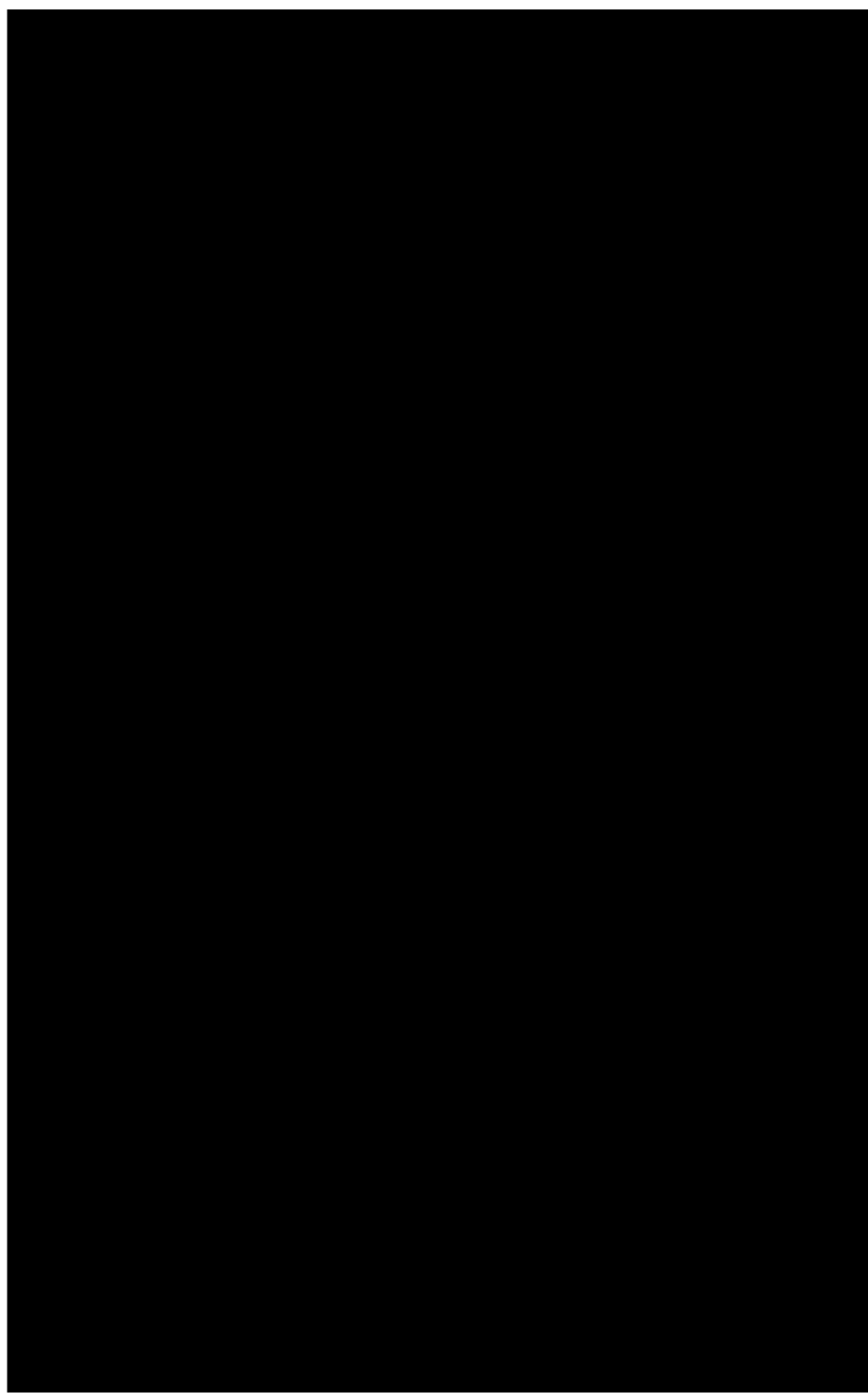
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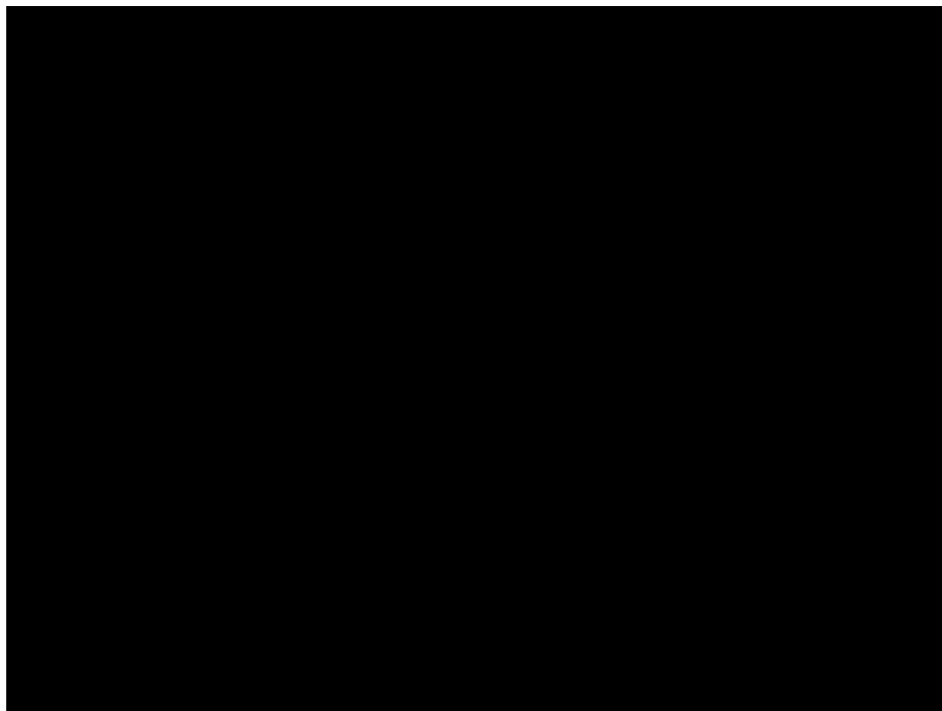
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